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SUBJECT: PAKISTANI BUSINESS COMMUNITY CAREFULLY WATCHING
U.S. REACTION TO STATE OF EMERGENCY

¶1. (SBU) Summary: Economic Section spoke with a wide range of contacts to gauge local business reactions to the November 3 imposition of a state of emergency. While the overall consensus is that it is too early to determine any long-term effects of the current crisis on Pakistan's economy, most observers pointed out that any U.S. actions to cut support to the Musharraf government are likely to have an effect on Pakistan's economic growth. If the crisis is not resolved quickly, any economic effects are likely to be magnified, as investors abhor uncertainty. The Karachi stock exchange (KSE) lost almost five percent November 5, with record volumes at nearly twice the norm, based on an unfounded rumor that Musharraf was under house arrest following a coup. End summary.

¶2. (SBU) Economic section staff spoke with a wide range of contacts, including Citibank (both trading and analysis divisions), ABN Amro Bank, American Business Council, Uch Power, and Marriott to see business community reactions to the November 3 imposition of a state of emergency. Our contacts were concerned about how U.S. actions would affect the assistance, foreign direct and portfolio investment, and remittance flows. The U.S. is Pakistan's largest trade and investment partner, with \$1.8 billion in FDI and \$1.45 billion in remittances to Pakistan FY2006-2007. Pakistan's exports to the U.S. totalled \$3.7 billion, while U.S. exports to Pakistan totalled \$2.0 billion for the same period.

¶3. (SBU) In its biggest one day loss, the Karachi Stock Exchange was down 4.8 percent in heavy trading today, nearly reaching the five percent loss threshold which triggers suspension of trading. Losses intensified in the early afternoon upon unfounded rumors that Musharraf had been deposed and was under house arrest. Most observers expect that the market will recover, particularly since losses prior to circulation of the coup rumor were in the 2-2.5 percent range. Today's buying and selling was almost double normal volumes.

¶4. (SBU) Aziz Rahman, Vice President of Citibank, pointed out that U.S. actions over the next few weeks will set the tone for economic developments. Highlighting the importance of the U.S. for FDI, remittances, and trade, U.S. policy on Pakistan can either make or break the economy. If U.S. and other international community policy reactions against the state of emergency are too severe, Rahman was concerned that investment and assistance, particularly from the U.S., might be diverted elsewhere. He was not concerned about decreases in worker remittances. He hoped that the U.S. would give the Musharraf administration a "slap on the wrist" and that

Pakistan's role in the war against terrorism would mean that Pakistan would not be subject to more extreme measures. Rahman also believed that retention of the current cabinet was very positive and gave investors additional confidence. He also expressed concern that any change in U.S. policy toward Pakistan might affect U.S. votes on international financial institution assistance.

15. (SBU) Reza-ur Rahim, Head of Investment Banking at JP Morgan and American Business Council Vice President, reiterated that the business community is watching the U.S. reaction to the state of emergency. He asked whether the U.S. was likely to impose sanctions, recalling the negative effect on the economy of sanctions following the nuclear tests in the late 1990s. Rahim was disappointed that Musharraf was unable to maintain the election timetable, but he opined that removal of the Supreme Court Justices was a positive move since the increased judicial activism had a negative effect on the economy. He cited the stalled privatizations in particular. Restrictions on broadcast media came as no surprise, since coverage of the May Karachi riots was too explicit in his view.

16. (SBU) Sakib Sherani, ABN-Amro's Senior Economist, told us that investors had already positioned themselves for bad news as seen by the large drops in the Karachi stock market last week, following rumors of an impending state of emergency. The next two to three weeks will be challenging but, barring massive street protests and a prolonged crisis, Sherani believes that the economy will not see any serious lasting effects from the current crisis. He also believed that the U.S. would be forced to distance itself from the Musharraf regime.

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17. (SBU) Sakib Ayub, in Citibank's Commodities and Currency Trading Department in Karachi, foresees some investment outflows from foreign investors but no overall meltdown. Local investors see that the situation is volatile, but the decision to maintain the current economic team in place means no change in current policy. Stability is key to long-term performance. He discounted the large KSE drop on November, pointing out that the market was down only about two percent before the circulation of the coup rumors.

18. (SBU) Murtaza Hashwani, President and CEO of the Hashoo Group, runs the Islamabad and Karachi Marriott hotels. He remarked that they had lost significant business in the past few weeks, due to the rumors of a state of emergency and increased suicide bomb attacks. He was optimistic, however, that business would rebound, commenting that Pakistani businessmen are accustomed to dealing with crises. He noted that foreign businessmen are making shorter trips to Pakistan now, and blamed the attention given to the media crackdown in the U.S. and Europe which magnifies the problem and provides a disincentive to travel. Restoration of the independent electronic media outlets by the end of the week is key to getting business back to normal in opinion.

19. (SBU) Pervaiz Khan, CEO of the U.S. majority-owned Uch Power said it was business as usual. His board is still comfortable going ahead with a \$400 million expansion, regardless of the imposition of the state of emergency. He thought the dismissal of the Supreme Court justices was a positive move since the large number of suo moto (cases initiated by the Supreme Court itself) had led to economic paralysis. (Comment: The Supreme Court had placed stays on a number of privatizations, and was hearing self-initiated cases on utility tariffs and drug prices, among others. End comment.) Khan emphasized the importance of free and fair elections respecting the initial timetable for ensuring continued economic growth and stability. He also expressed concerns about the U.S. statements on the state of emergency and hoped that they would not discourage investors.

¶10. (SBU) Comment: We note how carefully the business community is following U.S. reactions to the imposition of the state of emergency, particularly the Secretary's comment that the U.S. would review assistance to Pakistan. Possible sanctions were raised by several observers, perhaps because the economic effects of the nuclear test sanctions is still fresh and there is no interest in reliving that experience. We were also continually reminded of the importance of U.S. inflows to Pakistan's economic well-being, and the dangers that an overly negative reaction would decrease the amount of private inflows. Given Pakistan's considerable current account deficit, and any large decrease in inflows from the U.S., Europe, Japan, or the Gulf would put Pakistan's continued seven percent annual economic growth and ability to provide jobs for the some two million new entrants to the economy each year in peril. End comment.
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